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Chapter 10

Standardization and Compliance Costs: Relevant Developments at EU Level

Frank A.G. den Butter and John Hudson

Abstract This article discusses government regulation and the consequent compliance costs for the private sector from the perspective of transaction cost economics. In many cases, government regulation is shaped as legally binding standards. In order to comply with these standards, private sector firms meet various types of transaction costs, such as the bonding costs that the principal/agent relationship of government regulation brings about. On the other hand, good standards may reduce transaction costs. Therefore, optimal design of government regulation requires the design of standards with the lowest possible transaction costs. Due to network externalities and economics of scale, and in order to guarantee a level playing field, good coordination and unifying standards within the EU can be beneficial. This article provides examples of such standards.

10.1 Introduction

The administrative burden stems from compliance costs imposed on business by government. Compliance costs, in turn, are part of the more broadly defined transaction costs. Compliance costs stem from standards, but as we will argue, standardization may also be used to reduce transaction costs, both in the broad sense of trade transactions and in the more narrow sense of government regulation. Therefore, in order to understand how the administrative burden arises, it is important to understand standardization. In this chapter, we focus on the way (i) standardization impacts upon administrative costs, (ii) how standardization can enhance the efficiency of regulation and (iii) how standardization can be helpful in reducing transaction costs, and consequently reduce compliance costs as part of transaction costs. The chapter proceeds as follows. In Section 10.2, we look at ‘the economics of standards’. In Section 10.3, we

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look at standardization in the EU and in Section 10.4, specific examples of EU standards. Section 10.5 examines the EU's plans to control the administrative burden and in Section 10.6, we conclude the chapter.

10.2 The Economics of Standards¹

10.2.1 Standards: A Classification

Figure 10.1 summarizes how various types of standards can be classified according to their role in the economy. This role is encompassed more or less by the following general definition of a standard: “A standard is the specification of the characteristics of goods and services that provides information on the quality of these goods and services and/or enhances their interoperability”. The classification of standards is necessarily somewhat fuzzy as the characteristics may differ in different circumstances, which makes a clear separation of roles impossible.

The first distinction made in Figure 10.1 is between public and private standards. This classification refers to the way standards originate. Is the market responsible for their development, or was it a government initiative? The government has the ability to make the standards mandatory through the introduction of legislation. This is in contrast to voluntary standards. A further distinction is that between standards that are related to products and those related to production processes. A problem is that, often, the question whether a product meets a standard can only be answered by an inspection of the production process. This can be very costly, for both business and governments, particularly when the products are not produced domestically. This poses special problems to regulatory standards with respect to imported goods (and

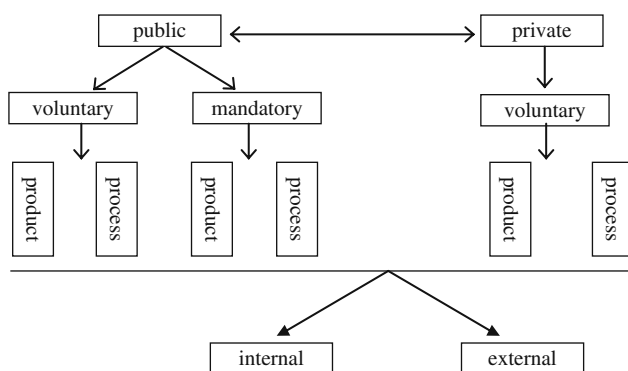


Fig. 10.1 Classification of standards

¹ Parts of this section are based on Den Butter et al. (2007a,b).

services), and may be a reason for international harmonization (e.g. within the EU) of standards. The third categorization of Fig. 10.1 relates to the difference between internal and external standards. Internal standards are subject to the control of companies that set them; external standards are to be considered as given for individual companies. In fact, regulatory standards will always be external standards. Yet they may result in the setting or upgrading of internal standards in a firm, in order to comply with the external regulatory standard.

10.2.2 Reduction of Transaction Costs Through Standards

It has already been mentioned that standards can contribute to the reduction of transaction costs (see Williamson, 1998; North, 1990, 1994) and therefore, more specifically, to the reduction of the administrative burden. It holds both for specialization and coordination of tasks within firms and for transactions at the market level. The more production processes are specialized and split up in various parts, the more coordination is needed and the more important it becomes to reduce transaction costs by means of standardization. On the other hand, a reduction in transaction costs by making better use of standards will promote a further fragmentation of the production process as compliance to these standards becomes less costly. An important reason why standards reduce transaction costs is that standards tend to reduce insecurity and information problems. In the literature, the best known effects of standards are network externalities and a reduction of switching costs (Blind, 2004). Standardization also increases the exportability of products, which facilitates economies of scale.

10.2.2.1 Typology of Transaction Costs

In principle, two types of transaction costs can be distinguished: “Hard” or direct transaction costs and “Soft” or indirect transaction costs. Hard transaction costs relate to costs that are readily perceptible and quantifiable, such as transport charges, import levies and customs authorities’ tariffs. Soft transaction costs are much more difficult to observe and measure. One can think of all kinds of costs of making and checking contracts, information costs, costs because of cultural differences and communication failures, tacit knowledge on legal procedures, formation of trust and reputation, network building, costs associated with risks and with rules and regulation in order to reduce risks, security requirements etc. These are of particular relevance for administrative costs.

10.2.2.2 Standards and Market Failure

In general, government intervention, and this includes the area of standards, can only be justified in the presence of market failure. Asymmetric information,

which is a form of incomplete information, can be a cause of such market failure. It relates to a situation where the buyer cannot observe the quality or specific characteristics of products. Akerlof (1970) gives the example of the secondhand car salesman. The buyer does not know the quality of car, so that, as a consequence, the bad cars (to speak in Akerlof's terms, the "lemons") are crowding the good cars ("peaches") out of the market. In this case, asymmetric information reduces the supply of good quality products. When asymmetric information results in the inability of consumers to include some relevant aspects of the product in their buying decision, it is possible that only products that score low on these aspects are offered on the market, since they cost less (WTO, 2005). This can be undesirable, and therefore, albeit under conditions, can be a legitimate ground for government intervention.

10.2.2.3 Standards and Trust

Trust is an important mechanism that enables the reduction of transaction costs, especially in the frequent cases of incomplete and/or asymmetric information. In such cases, contracts can never be complete, and trust will always play a role somewhere in the transaction process (Den Butter and Mosch, 2003; Mosch, 2004). Standards may very much contribute to such formation of trust. The reputation and reliability of the quality labels have to be built up slowly, because the formation of a trustworthy reputation will need some time. Explaining the standard and what it stands for to its users on the one hand, as well as adequate supervision, and careful development of a reputation of trust and reliability on the other hand, are needed to make the standard a success. Trust in standards will also contribute to the reduction of compliance costs when it enhances the intrinsic motivation to comply with the standard.

10.2.3 Why Should Governments Bother About Setting Standards for Regulation?

The previous discussion on the relationship between standardization and transaction costs (including compliance costs) suggests that government intervention in standardization can be needed in specific cases. Leaving the development of standards entirely to the market can sometimes result in solutions that are suboptimal from the perspective of social welfare. The existence of market failure is a necessary – though certainly not sufficient – condition for government intervention. Mandatory standards can help with many of the aspects of market failure. Firstly, they result in the removal from the market of all products that do not comply with the minimum standard. Voluntary standards in combination with labeling can provide buyers with sufficient information on quality differences in a situation where both low and high quality products are supplied. Negative labels can be made mandatory by the government for producers of

goods that do not comply with a standard. Positive labeling is used by firms to enable the consumer to distinguish (often more expensive) products that comply with high standards. Therefore, standards can reduce, or even take away, the problem of asymmetric information identified by Akerlof, reducing the transaction costs as they enable more and better transactions. This also benefits the reputable firm, particularly ones selling high quality products, who gain from reduced signaling costs and consumer uncertainty.

Apart from internalizing negative externalities, it is especially through reducing information problems that the government can benefit society. This can be done by the introduction of a quality label that provides the user with information on several relevant aspects. Such a multidimensional quality label facilitates the supply of products with various quality levels. This system aims at promoting product differentiation which enhances consumer welfare. Although such a standard does no longer imply a unified set of minimum requirements that all products should comply with, it can still be regarded as a standard. Joining this type of standard can be voluntary or mandatory. It is very likely that producers who have a low score on certain dimensions will not voluntarily join the standard, in the hope that consumers will expect an average quality of the product in the absence of information. This can be undesirable. Therefore, the EU-energy label, for example, is mandatory and must be used by all producers.

The government can also standardize its own services. Such standardization may lead to a considerable reduction of compliance costs when these standards relate to government regulation (e.g. in the case of permits). A special case relates to services provided to multinational organizations. These organizations often have to take all sorts of differences in rules and legislation that exist between different countries into account. This can bring about high transaction costs for them. Especially small countries with legislation that differs substantially from that of other nations will make themselves less attractive to multinationals. Harmonization and less complexity can enhance the ability of a nation to attract foreign investments. An example is harmonization and reducing transaction costs with respect to customs regulation, where many changes already have been made through the WCO (World Customs Organization).

10.2.4 Transaction Costs of Government Regulation

The transaction costs of the implementation of government policy result from the principal/agent (agency) in policy implementation. Here the government acts as principal and the citizens and businesses as agents. In this situation, three types of costs can be distinguished which are all part of the total transaction costs of government regulation. The first type of cost is the costs for the government itself. These are, in the principal/agent terminology, the monitoring costs. Part of these are administration costs, but there are also additional costs which come with the design of the regulatory measures. Therefore, the implementation costs

for the government are generally considerably higher than the amounts which appear in the budget (payment of subsidies, receipts of levies). The additional costs include salaries of the civil servants engaged in policy preparation, implementation of regulatory measures and other monitoring activities. Costs also relate to subsidies which are not granted, and allowances for tax exemptions.

The second type of costs is the bonding costs for the citizens and businesses. These consist mainly of compliance costs, which are the focus of this volume. Here, all compliance costs of the laws and legislation by the government should be taken into account. They are the direct financial costs of levies, but also capital investments and all other remaining costs needed to meet the obligations of laws and legislation. These compliance costs also include the costs of informing the government (sheer bonding costs), which can be regarded as the administrative costs in a strict sense. The policy debate on diminishing the administrative burden of government regulation usually focuses on these costs only. Calculating total compliance costs can, however, be rather complicated. For instance, when firms are to meet the requirements of environment legislation or of safety regulations, they have to make all kinds of investments in the production processes and management procedures of the firm. These costs can only be partly counted as transaction costs of government policy, as some of these investment costs would be made anyhow from the firm's own commercial perspective. So, there is a need to separate these kinds of compliance costs into external compliance costs, which are added to the transaction costs, and internal compliance costs, which are not transaction costs originating from government regulation. Of course, such a split between external and internal compliance costs has, to some extent, an arbitrary character and requires a good insight into the management of the firm. Boog and Nijssen (2007) provide an example of how to calculate these various types of compliance costs for specific cases.

The third type of cost is much more difficult to quantify, namely the societal costs of the residual loss. These arise because the reaction of the agents to government regulation will never be in complete agreement with the objectives of the government. The difference is the residual loss. Principal/agent contracts should be designed in such a way that the total agency costs (monitoring costs, bonding costs and residual loss) should be minimized. It implies that agency contracts should not try to reduce residual losses as much as possible, nor should they seek to minimize costs for the government. There should be a good balance between all three types of costs.

The above discussion shows that the principal/agent theory provides an adequate framework for a taxonomy and further categorization of the transaction costs of implementing government regulation. Total transaction costs of government regulation consist of the netted sum of the three components. The expression netted sum indicates that (for e.g.) subsidies granted by the government to private agents are counted as costs by the government, but should be subtracted from the costs incurred by the private agents for obtaining the subsidy and the bonding costs met by these agents to demonstrate to the government that the subsidy is well spent. A similar netting of costs holds in the case of regulatory

levies, which are costs for the private agents but are to be subtracted from the administrative costs and other monitoring costs that the government makes when raising the levies. It should, by the way, be noted that in case of regulatory levies, private agents who are subjected to these levies, face higher costs than the sheer amount of the levies. There are additional compliance costs associated with the regulation of the levy, which also have the character of regulatory costs. This aspect is often neglected in decisions about the size of the levies.

Government attempts at minimizing total implementation costs do not come solely from the government. In order to obtain an optimal result, coordination and consultation with stakeholders is needed. This is especially in line with the tradition of compromise and consensus in the Dutch polder model. Such consultation should be institutionalized. It can take place in so-called “matching zones” which are meetings of relevant stakeholders in a specific setting and with a specific agenda in order to come to a low cost compromise. In the principal/agent terminology, these meetings can be seen as the (virtual or actual) meeting place between the principal and the agents, with the purpose, as far as possible, of aligning goals and reducing monitoring and bonding costs. Also important is the choice of participants in these meetings. On the one hand, all interested parties should be represented in the matching zone, but on the other hand, the coordination task should not become too complex. Discussions and consensus formation in these meetings should be restricted to specific regulatory measures and standardization per se and should not be blurred by side issues which can be discussed elsewhere. This problem of forming an optimal composition of participants in the meetings is comparable to that of the optimum scope for administrative entities. In the Netherlands, some (positive) experience with such matching zones was obtained in the field of the implementation and compliance with tax legislation (the Van Lunteren commission). Such stakeholder discussions can also be valuable for the government as they may reveal contradictory legislation from different government departments.

10.3 Standards and Standardization in the EU

10.3.1 The New Approach: In pursuit of the Single Market

In the EU, the choice of standards rather than directives initially stemmed from the difficulties encountered by European institutions in imposing compulsory measures (Brunsson and Jacobsson, 2000). The recourse to standards was therefore a pragmatic response to the absence of any constraining means at the EU's disposal to accompany its regulatory activity and to make the single market an economic reality. Standards facilitate cross border trade and give consumers, and indeed firms, confidence in the quality, safety and specification of goods that comply with those standards. They also reduce search costs which are particularly high for consumers thinking of buying products imported from other countries.

The ‘New Approach’ to standards and regulation in Europe was intended to limit the regulatory function of the Commission and Council to specifying ‘essential requirements’ that producers must meet in terms of safety, health, environmental and consumer protection. Theoretically, at least, these were to be voluntary. Responsibility for developing standards was given to the European Standards Organizations (ESOs). This has led to the proliferation of ‘voluntary standards’ that give products conformity with essential EU directives and thus access to EU markets (Mattli, 2001). However, the need for such access means that in reality, they are not voluntary (Blind, 2004). This lack of clarity raises the possibility that they may be omitted from calculations of the administrative burden.

10.3.2 The EU Standards Architecture: CEN/CENELEC and ETSI

There are three main ESOs: (i) CENELEC, (ii) ETSI, and (iii) CEN. CENELEC prepares ‘voluntary’ electrotechnical standards and ETSI (the European Telecommunications Standards Institute) produces telecommunications standards. CEN, the European Committee for Standardization, focuses on voluntary technical standards which promote free trade, the safety of workers and consumers, the interoperability of networks, environmental protection, the exploitation of research and development programs, and public procurement. It is, for example, responsible for air traffic management standards, automotive fuel standards, common structural rules for the design of buildings, the safety of consumer products, solid biofuels, food, healthcare, the conservation of cultural property, etc. Of the three ESOs, it is mainly CEN who produce standards which impact upon the administrative burden. The Technical Committees (TCs), of which there are currently 275 active ones in CEN alone, play a key role in standard development. The TCs draw on expertise from associated standard bodies which are generally organized by European industry associations (Goerke and Holler, 1998). This too is a cost to business related to regulation, but one which is seldom considered. The standards bodies tend to emphasise consensus, but as final voting is based on a qualified majority, this is more of a subjective than an objective concept. Thus, it is possible that countries have to accept as their national standard something they voted against.

10.4 Examples of European Standards

10.4.1 Examples of European Standards: Packaging and Distribution of Drugs

The Dutch plant of the multinational drugs company Merck, Sharpe & Dohme (MSD) provides an example of how internal and external standards can affect corporate management. MSD Netherlands delivers drugs of the mother

company to customers and regions all over the world. The Dutch plant coordinates the logistics, packs the drugs, and makes sure that all rules and legislative requirements have been met. Within MSD, there used to exist an enormous diversity in packages. Thus, MSD developed an internal standard to reduce packing costs, by – for example – using one package for a group of regions. However, standardization of external regulations, which in the case of drugs are set by the EU, national governments and health organizations, is also important for MSD. MSD has to deal with many different prescriptions in various countries with respect to packaging and distribution of drugs. Obviously, increased harmonization would considerably reduce their transaction costs. Harmonization could also be beneficial to public health when the harmonized standards would imply the use of best practices with respect to information on drugs contained in the package. However, up to now, the EU rules for packaging of drugs only provide limited costs advantages to MSD as the individual member states are not fully complying with the EU regulations or have specific local regulations. Nonetheless, the EU is moving in the direction of more uniform regulation in this respect. For example, the European Directorate for the Quality of Medicines and Health Care (EDQM) was set up in 1996 and part of its current mission is to establish and provide official standards for the manufacture and quality control of medicines. Such standards relate to both reducing transaction costs and correcting for market failure.

10.4.2 Examples of European Standards: Food and Product Quality

The EU has an integrated approach to food safety which is designed to ensure effective control systems and compliance with EU standards (Hudson and Hudson, 2008). This covers how farmers produce food, how it is processed, how it is sold and the nature of the information provided on the labeling. The rationale for this lies partly with concerns, partly about health and public safety and partly about facilitating the single market. Underpinning this approach are more than 400 standards developed by CEN in the area of food safety alone as well as others related to general product quality. The European Food Safety Authority (EFSA) was set up in 2002 following a White Paper recommendation of 2000 and partly in response to food health scares such as ‘mad cow’ disease or BSE (Ugland and Veggeland, 2006). Its role is currently restricted to risk assessment and risk communication to interested parties and the public at large. The EU has recently been considering the role of regulation in protecting consumers and the need to strike a balance between a high level of competitiveness and consumer protection.² In part, as always, their concern

² More generally, consumer protection is about making sure that all consumer products are safe and that consumer rights are properly protected, that consumers have the information they need to make a judgment and are not misled.

is based on the need to promote trade and competition within the single market. Current legislation allows member states to adopt more stringent regulations – i.e. ‘minimum harmonization’. This has resulted in added cost to businesses as they attempt to trade over borders and also increased consumer uncertainty about buying products from other EU countries. Within the context of Section 10.2, these standards correct for market failure and facilitate trust, as do those relating to waste.

10.4.3 Examples of European Standards: Waste Disposal Standards

The WEEE regulations make producers of Electrical and Electronic Equipment (EEE) responsible for these products when they become waste. The aims of the WEEE directive include, e.g., (i) to reduce WEEE disposal to landfill, (ii) provide for a free producer take-back scheme for consumers for end of life equipment, and (iii) to set and achieve targets for recovery, reuse and recycling of different classes of WEEE. At the moment, transposition of the WEEE directive into national law has revealed major differences from one legal system to another. Thus, it is being recommended that the Directive should be revised to increase harmonization (Savage, 2006). Related to WEEE is the RoHS Directive connected with Restrictions of Hazardous Substances in Electrical and Electronic Equipment which, from 2006, put limits on the maximum permitted level of lead, mercury, cadmium, etc. in a product. As is often the case, underpinning this work on RoHS, WEEE and the environment in general is the work of a number of ESO technical committees. For example, CENELEC technical committee TX 111X has developed standard EN 50419: 2006 dealing with the marking of electrical and electronic equipment in accordance with the WEEE directive. All of this puts obligations on firms which they both have to meet and be able to prove they have met.

10.4.4 Examples of European Standards: EU Standards for Financial Transactions in the Capital Markets

According to data from the BIS in 2005, financial transactions in worldwide capital markets amounted to about 1400 trillion dollars. It appears that the direct costs of handling these financial transactions between EU Member States are two to six times as high as in the US. The European Commission aims at reducing the costs of these transactions to a level similar to that in the US (Giovannini, 2001). However, the trading of financial assets involves transaction costs which go far beyond the direct and easily quantifiable trading costs. For example, The London Stock Exchange (LSE, 2002) has calculated that the

formation of a European clearing and settlement platform can incur a saving in direct transaction costs of € 1.6 billion. But, estimates of the potential cost savings on indirect costs vary from € 5 billion to € 40 billion per year. The successful completion of a transaction depends to a large extent on the quality of the transaction and speed of communication. However, besides institutional reforms, there is an obvious need for better standardization of the handling of financial asset transactions at the level of the EU. Here, due to differences of the types and sizes of the various stock exchange markets between the EU and the US, a mere copy of the American way of regulation at the EU level seems unwarranted.

Compared to the EU, US asset trade is much more specialized in specific financial products and derivatives, and has large trade turnovers. This specialization (in niche markets) increases the 'asset specificity' of the trade and necessitates specialist knowledge of how to trade these financial products and derivatives. It increases, in principle, the transaction costs but in offering opportunities for professionals to exploit economies of scale in trading large volumes, it may also reduce transaction costs. In the EU, there is also some kind of 'asset specificity' in the financial assets trade but it has a different character than in the US. Here, there are mainly national differences in property rights and regulations that lead to product differentiation. This increases the transaction costs in the EU. Therefore, the EU should develop its own standard on the basis of product harmonization in order to reduce transaction costs. A design for an EU standard which reckons with these differences is given by Den Butter and Corveleijn (2007). This is clearly an example of a standard whose prime purpose is to reduce transaction costs.

10.5 EU Regulation of Standards in the EU

10.5.1 The Adoption of the Dutch Model Throughout the EU

The growth of standards has contributed to the growth of the administrative burden and this has led to growing concern in the EU, as well as in some individual countries. Thus, on March 23, 2005 the European Council requested "the Commission and the Council to consider a common methodology for measuring administrative burdens". The approach proposed by the Commission is based on the Dutch SCM methodology, discussed elsewhere in this volume. It is proposed to use the same core equations, the same relevant cost parameters and the same formulas for expressing the frequency of administrative activities and the same approach in the assessment of the performance of a "normally efficient entity".

The EU has estimated that administrative costs by member states are as in Table 10.1. The EU has calculated that a reduction in the administrative

Table 10.1 Administrative costs by member states as a share of GDP

Austria	4.6%	Ireland	2.4%
Belgium & Luxembourg	2.8%	Italy	4.6%
		Netherlands	3.7%
Czech Republic	3.3%	Poland	5.0%
Germany	1.9%	Portugal	4.6%
Denmark	1.9%	RE*	6.8%
Spain	4.6%	Slovakia	4.6%
Finland	1.5%	Slovenia	4.1%
France	3.7%	Sweden	1.5%
UK	1.5%	EU25	3.5%
Hungary	2.4%		

*RE combines the Baltic member states, Malta and Cyprus.

Source: COM (2006) 691 Final, based on Kox (2005).

burden by 25% would eventually lead to an increase in EU GDP of 1.6% (COM, 2006).

The source of the administrative burden arises from four different levels: (i) international, (ii) EU, (iii) national, (iv) sub-national. The split shown in Table 10.2 suggests that the most important source of burden comes from national governments, although this may be changing as the EU expands its regulatory activities. Specifying where the burden originates can be difficult. Often, a measure originates at, say, EU level to be implemented at national and then sub-national level. Often too, the original impetus would come from an international standards agency such as ISO. At each stage of the chain, there is the potential to add to the original obligation, a process termed ‘gold plating’. International law always needs ‘transposition’. This is also the case for EU Directives, but not EU Regulations which are directly applicable.

The EU’s role is a twofold one; first, in controlling its own administrative burden, and secondly persuading all the member states to follow. At the moment, there is enthusiasm amongst some member states to do this and the Netherlands, Denmark, the Czech Republic and the UK are well down this path. But other states appear less enthusiastic, and without EU pressure, would probably only make limited progress. As such, the EU Commission has set a target for the whole of the EU to reduce administrative costs by 25%. In addition, it is envisaged that targets will also be set in specific policy areas where both the administrative burden is particularly heavy and there is the

Table 10.2 The Distribution of Administrative Costs in Denmark and the Netherlands

Share of administrative costs by origin of legislation	Denmark	Netherlands
Originates directly in international law	28%	43%
International origin but implemented nationally	15%	13%
National Origin	57%	44%

Source: COM (2006) 691 Final, based on Denmark and Netherlands baseline measurement

potential for significant cuts. The EU believes these figures are reasonable and cite results from the four states that have carried out baseline measurements that there is a potential for reductions of this size by focusing on costs originating with both the EU and at the national level. It is also worth emphasizing that three of these four countries have costs below the EU average, as shown in Table 10.1 and one assumes that if a 25% reduction is feasible for these states, then still more could be expected from certain other countries.

10.6 Summary and Conclusions

In the EU, many of the standards and regulations have grown in recent years due to factors such as technical change and rising expectations. Technical change means that products can be produced today which were not previously possible, but the health and safety of products such as mobile phones and GM foods need to be regulated. Rising expectations mean that we have legislation now which we did not have previously simply because we now demand more from products and production processes. But not all the trends are adverse. The development of the computer and the internet will have substantially reduced the compliance costs of e.g. collecting VAT for the government. The growth of EU and international standards will have reduced, and reduced considerably, the administrative costs to firms associated with international trade. Nonetheless, it is probably true that the pressures on the administrative burden will tend upwards in the coming years. This means that if it is a target of government policy to stabilize or even reduce that burden, then finding more efficient ways of doing things, rather than doing fewer things is probably essential, although particular attention needs to be focused on the work of the ESOs to ensure that new standards imposing obligations on business are genuinely necessary.

Standards and associated regulatory activity represent a cost on business, but it is not a cost without benefits for both society and for firms. In terms of society, standards which ensure product quality, particularly related to safety, provide a clear benefit to consumers in correcting for market failure as outlined in Section 10.2. But they also benefit the firm in several ways. First, in addressing the problem of asymmetric information, they provide a guarantee to the consumer that they can buy goods with confidence; this will economize on individual search costs, possibly expand the market and also potentially allow firms to economize on signaling expenditure (Jones and Hudson, 1996). Moreover, firms too benefit from such guarantees. In agriculture, for example, they reduce the spread of infectious diseases amongst livestock. Again, within the context of market failure, other standards and regulatory activity ensure the health and safety of the workforce. This too is an advantage to society, but also to the good employers who do not have to unfairly compete against firms with less rigorous standards. Thus, the design and institutional set-up of government regulation should be such that total transaction costs, i.e. compliance costs for

the private sector, implementation and control costs for the regulator and (indirect) costs for society should be minimized. It implies “efficient” regulation and not necessarily deregulation, as insufficient regulation or laxity in execution of regulation may bring about high societal costs in the long run, e.g. because of costly accidents and loss of faith and trust in government. It must also take into account that some regulation and standards can reduce transaction costs for business. Hence, the view that no new regulation can be brought in unless some other burden disappears in many cases is almost certainly wrong and, if followed through, would expose society to unnecessary risk.

Because of this, the next stage in the process of controlling the administrative burden may well be one of measuring not just the ‘gross burden’ but the net one too. That is measuring both the costs and the benefits. A proper cost/benefit analysis should be a major element in the discussion on the administrative costs of regulation. In case of new regulations or standards, the benefits should exceed the costs, and the regulation should be designed in such a way that, given the warranted scope of regulation, costs should be minimized. Obviously, these costs do not only comprise administrative costs in a narrow sense, but include all kinds of transaction costs mentioned in Section 10.2. Inclusion of these (often soft and difficult to measure) transaction costs in the Dutch SCM methodology seems warranted in order to enhance the quality of that methodology. In addition, it shows that a target of, say, merely reducing administrative costs by 25% can be suboptimal from the perspective of welfare economics. In those cases, where actual deregulation is warranted, i.e. a relaxation of rules and restrictions or of quality standards set to products and production processes, again, a full fledged cost/benefit analysis is in order. Here, the loss of benefits to society of regulation, e.g. of allowing for higher risks or being less strict on internalizing negative externalities, should be smaller than the gains in terms of less transaction costs. However, in as much as the focus is on transaction costs affecting business, it should be on all transaction costs and not just those imposed by government. Hence, if transaction costs are high because of market failure, then government action in reducing the extent of this market failure is as valid an area of concern as reducing the administrative burden per se. Standards impose transaction costs on business, but equally some standards can reduce transaction costs whilst simultaneously benefiting society as a whole. This has been shown in our analysis of the financial and pharmaceutical industries.

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